

Industry Circular

US Treasury Department



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Internal Revenue Service

Alcohol and Tobacco Tax Division
Washington, D.C. 20224

Industry Circular No. 68-16

May 16, 1968

DIVERSION OF TAX-EXEMPT CIGARETTES

Manufacturers of tobacco products:

Printed on the reverse of this industry circular is information recently sent to proprietors of export warehouses concerning the conviction of a warehouse manager for diversion of tax-exempt cigarettes.

While the operations at tobacco products factories differ from those at export warehouses, this case vividly illustrates that constant vigilance is required at all levels of distribution of tax-exempt tobacco products. Such vigilance is required for the protection of the revenue and to safeguard your interests in the value of the products and your liability for the tax.

We therefore ask that you consider the circumstances leading to the manager's criminal conviction and the need for periodic reviews of the system of internal controls exercised in your factory to determine its adequacy in eliminating conditions which could result in cases such as the one described.

Inquiries concerning this circular should refer to its number and be addressed to your Assistant Regional Commissioner, Alcohol and Tobacco Tax.

A handwritten signature in dark ink, appearing to read "Harold A. Serr".

Harold A. Serr
Director, Alcohol and Tobacco Tax Division

Proprietors of export warehouses:

Purpose. This is to advise you of the arrest and conviction of the manager of an export warehouse for diversion of tax-exempt cigarettes and to suggest some positive steps you should consider for prevention of such diversion from your warehouse.

Background. The manager was authorized by the export warehouse proprietor to prepare, sign, and submit documents required under Chapter 52 of the Internal Revenue Code, and was also entrusted with the physical accounting for the tax-exempt articles in the warehouse. An investigation disclosed that over a five-month period the manager fraudulently diverted 291,000 cigarettes for his own benefit. He was arrested and tried in a Federal court for illegal disposition of tobacco products removed from an export warehouse and for preparation and presentation of fraudulent documents. He is now serving an 18-month sentence in a Federal prison.

Responsibilities of the proprietor. The proprietor of an export warehouse is responsible for the actions of his employees in respect to tax liability on tax-exempt articles in his warehouse and for submission of true and accurate notices and reports. In this case the proprietor of the export warehouse was liable for and required to pay the tax on the cigarettes diverted by his manager. This tax liability is, of course; a civil matter distinct from the manager's criminal actions. The tax paid was therefore an expense in addition to the basic cost of the cigarettes which the proprietor also lost.

Precautionary measures suggested. For your own protection as well as for the revenue protection you, as an export warehouse proprietor, should take reasonable precautions to assure the honesty of officers or employees entrusted with control over tax-exempt articles and authority to execute required Internal Revenue Service notices and reports. It is desirable that cross-checks and controls be a part of normal operations to provide that no one person has full control and authority over receipt, removal, physical inventory, recordkeeping, and reporting of tax-exempt articles. Where such responsibilities are properly divided to provide effective cross-checks both the proprietor and the revenue are better protected from distressing and expensive situations similar to the cited case.